RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

SINCE 1958 •

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Aug. 24, 1988 **LETTER 998**

Aug. 12 DJIA 2037.52; PTI 2740; A-D Ratio -11.09
Aug. 19 DJIA 2016.00; PTI 2738; A-D Ratio -11.29
Current Dow Yield: 3.79%; Dow P/E: 12.0
Dow 200-day MA: 2015; DowPow: 671
Percentage of undervalued blue-chip stocks: 20%

THE PHANTOM: This business isn't easy. But after three decades of writing market letters, I'm still obsessed with the stock market, as obsessed with it as the day my thoughts first focused on Wall Street. And to be honest, I believe you have to be obsessed if you're going to come out ahead in the battle of the bull and the bear. To me this is a 24-hour business. And I mean that literally. I think the market (consciously or unconsciously) is always on my mind. When it comes to Wall Street, I feel like the Biblical Jacob struggling all night with the phantom wrestler. Don't ask me why, after all these years, I still do it. It's built into my psyche, I guess.

I woke up yesterday around three in the morning. And before I knew it I was having this argument with that phantom visitor. "Russell," he demanded, "do you really believe you're right, do you still think it's a primary bear market?" In an instant I was wide awake and answering, "Yes, I think I'm right. Look at this: Business is straining at capacity, factories are humming, consumers are still busily buying, cars sales are strong, US exports are booming. The whole economy has pushed to the point where inflation is starting to heat up. The latest Producer Price Index figure was up 0.5% for the month, which amounts to an annualized 6% inflation rate. The heat in the economy has frightened the Fed to the point where only a few months before the election it has boosted the discount rate a full half a percent."

"So what!" growls my phantom visitor. "Russell, what are you trying to prove?"

"You fool," I almost shout, "Can't you see it's a bear market? In the face of all this hot business news the Dow today is only 290 points above its crash low (after 10 months of trying) AND IT'S A FAT 700 POINTS UNDER ITS 1987 BULL MARKET HIGH. What does that tell you? What does this economy have to do to move the Dow up from here? Can't you see that informed interests are SELLING into all this good business news! Can't you see that the bear is making a fool of the buyers! Can't you see that it can't get much better -- and in spite of this the Dow is still floundering around in nowheresville, and so are the great majority of stocks. It's a bear market, my friend, and you're whistling in the dark." With that I cease wrestling with the demon of the night. As quickly as he appeared, he is gone. Now maybe I can get another hour or two of sleep before the dawn. Maybe.

THE PICTURE: There's a well-known financial commentator on San Diego radio (he reads this Letter) who insists on blaming the rotten market action on what he terms "the chicken littles." This commentator is very angry at those of us who are bearish. He feels that we should be brave and have faith in the future. And, of course, I do have faith in America's future -- its future after this bear market is over.

But this radio guy can't get it into his head (or he doesn't want to) that this is a primary bear market. Which, of course, has nothing to do with whether you and I are "chicken littles." It has to do with reality, with the tidal trend of the markets across this nation and throughout the world.

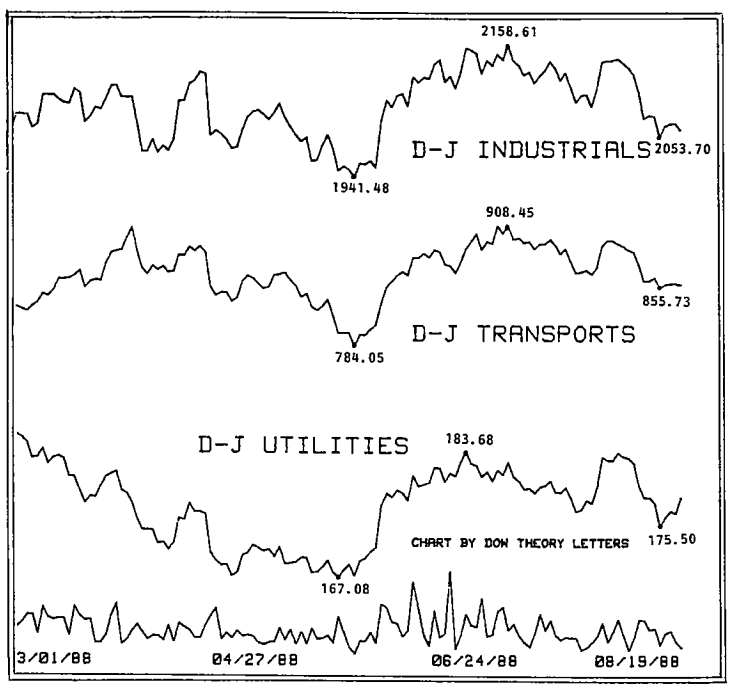
It's axiomatic that people resist (and are angry at) bearish market action during the first phase of a bear market. People resent the market going down here in late-'88, and they particularly resent it because business remains good. As for the bear -- he couldn't care less. For this is the phase in the bear market when stocks go down for no obvious or apparent reason. And in the current instance, the first phase is lasting longer than usual (as I was afraid it would).

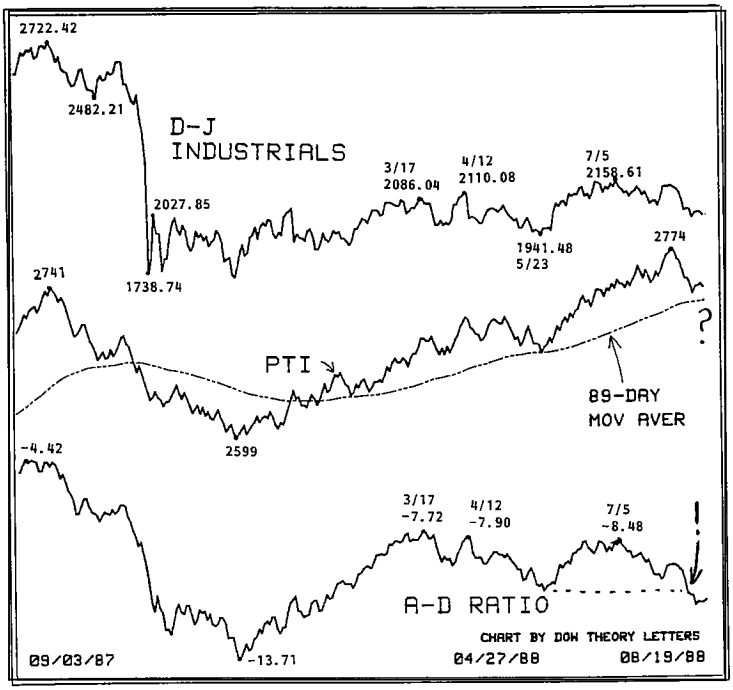
There are a number of reasons why this first phase is lasting so long. For one, the dollar has collapsed, thereby giving a major boost to US exports, and this in turn has kept our factories humming. For another, American consumers have continued going heavily into debt as the great buying binge of the '80s goes on and on.

But the collapsed dollar will have its adverse effect on the nation's future, and the consumers' borrowing is, of course, simply borrowing from their own future purchasing power. It's one thing to borrow your head off during a bull market, but quite another to go heavily into debt at the beginning of a bear market. I think we will see what I'm talking about as this bear market wears on.

I've been warning all along that this was fated to be a long, extended, tedious bear market. It will be long because the government will fight the bear tooth and nail. Here in '88 the government is fighting the bear with bank bail-outs, farm bail-outs, and assorted big spending programs. In the end the bear will win (as he always does), but it's going to be a fight all the way -- count on it.

Those of us who watched the government's multi-year fight against gold understand this only too well. The primary trend of gold was





up all during the '70s, but the US government fought that trend with all the power at its command. In the end gold blew its top, roaring $800 an ounce above the US government's insane "fixed official price" of $44. Our ding-bat Treasury still insists that gold is worth only $44 per ounce. But, of course, the real market couldn't care less.

All right, let's turn to the stock market. The basic, overriding, all-important consideration at present is that we're in a primary bear market.

What does that really tell us? Here's what it tells us. It tells us that despite any and all good news that may be coming up, regardless of who wins the election, despite any temporary stock rallies, this market ultimately is headed down. It may take a month, it may take six months, it may take a year or even two years (although I sincerely doubt it) but the lows of last October are fated to be broken. Why? Why will the Dow low of 1738.74 and the Transport low of 661.00 ultimately be broken?

They'll be broken because we're in a continuing bear market, and that's what bear markets do. They take out preceding lows. They cut through so-called "support levels" like a hot knife through butter. Bear markets take stocks down and down until the worst that can be seen ahead has been fully discounted in the price structure, until the last seller has dumped his shares, until the market is thoroughly exhausted on the downside.

But how do we know the market wasn't exhausted at last October's lows? Or how do we know that the market isn't exhausted here today?

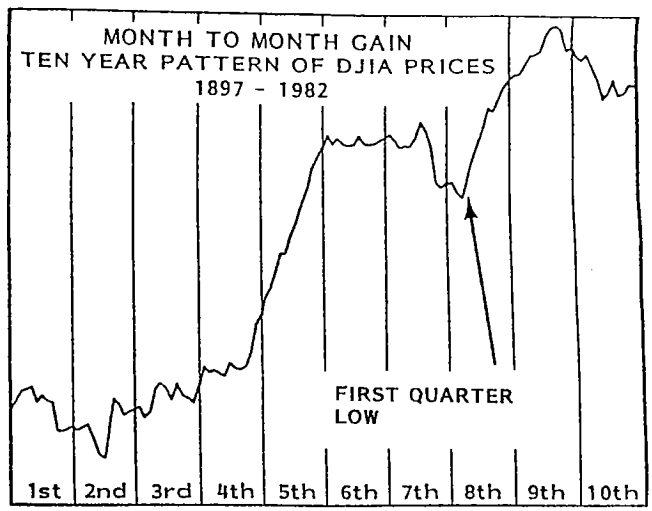
My answer is that the economic news hasn't even turned bad yet. Auto sales are still going up, retail sales are still rising, unemployment levels are still declining, business is still good. We're still in the early (first) phase of the bear market. The Dow may be down over 700 points from last year's high of 2722, the Transports may be 235 points below their '87 high of 1101, but it's still early for the bear. That's the sad story that I'm obliged to repeat over and over again to my subscribers. But then you don't pay me to spin fairy tales. You pay me to tell you the truth (at least, the truth as I see it), and that's what I do to the best of my ability.

On August 9 the two Averages, Industrials and Transports, broke simultaneously below their July lows (see page 1 chart). They did so on increasing volume of 201 million shares. The joint breaking of those lows constituted a kind of "mini-bear signal," and the break was followed by persistent weakness in the market.

That action of August 9 turns the secondary trend of the market down, but a much more important set of lows lies ahead. These are the May lows of 1941.48 for Industrials and 784.05 for the Transports. If those May lows are violated by both Averages, I would say that the bear had fully awakened from his sleep and that we were close to the point where I would expect a downturn in business.

If or when business turns down, that will tell us that the bear market has moved out of its first phase and into its second phase. The second phase of a bear market (this is for the benefit of new subscribers) is the phase where stocks decline as they reflect obviously deteriorating business conditions. Here earnings turn bad to the accompaniment of sudden and "unexpected" collapses in individual issues. But let's not get ahead of ourselves. It's still early in the bear market.

What the market doesn't do is often as important as what it does do. This chart of the so-called "decennial pattern" (chart courtesy of *Growth Fund Guide*) shows us the typical pattern for each year of the decennial pattern. Note that years ending in 5, 8, and 9 have tended to be strongest years. Furthermore, election years also tend to be strong years. So on two counts, 1988 (a year ending in 8) should be a strong year. But so far, it hasn't been. In fact, stocks as measured by the A-D ratio have already wiped out all of 1988's meager gains! So what is this telling us? As I see it, 1988's poor performance is telling us that a stronger force than the decennial pattern and the election-year pattern is at work. That force is the primary bear trend.



Items: My Primary Trend Index (PTI) hit a high of 2774 on August 3; since then it has declined sharply. Currently the PTI is 8 points above its 89-day moving average. But as long as the PTI holds above the MA it is in the bullish mode.

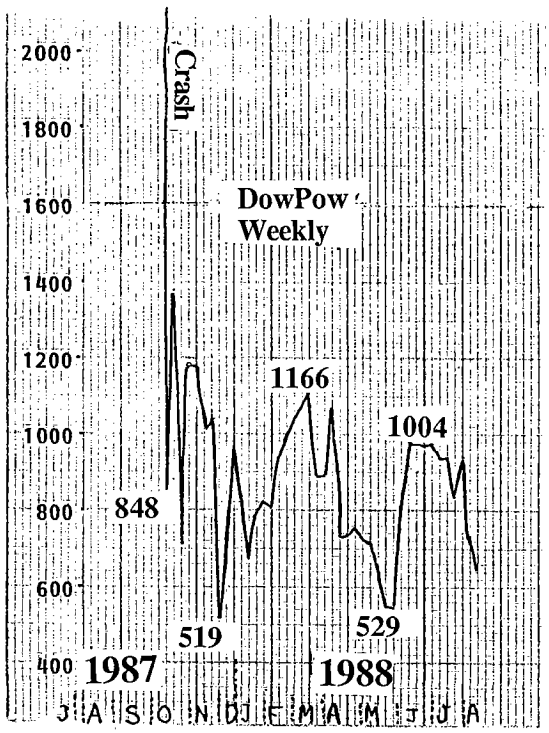
However, DowPow (which is my proprietary index of the Dow adusted for the action of the advance-decline ratio), after moving sideways ever since the crash, is now flirting with its low again (the weekly chart of the DowPow is shown below). A break below the December low would be very bearish for the market.

In his latest report, Marty Zweig notes that his stock market Valuation Model is now "in the moderately overvalued range," while his "new Monetary Model stands at 18 points on a scale from 0 to 100." Notes Marty, "That's the worst score since just before the crash. When combined with Valuation, the current readings have historically produced 14.5% annualized losses on the S&P 500 Index."

When this market rallies, it meets resistance as measured by the unimpressive number of issues advancing and as measured by the number of issues that are unchanged. Interestingly, August 8 produced the greatest number of unchanged issues (588) in NYSE history, after which the market broke sharply.

Both credit balances and debt (margins) on the NYSE are in downtrends. A decline in both of these items has a close correlation

with bear markets, and I watch these statistics (which are issued monthly) carefully. (Note: As a bear market progresses, the speculators, who tend to use margin debt, are slowly but steadily driven out of the market.)



INVESTMENT POSITION: This bear market is not going to be a 100-yard dash -- it's going to be a marathon. Therefore, I'm recommending that my subscribers get ready to use the scarcest commodity in this business -- patience. This is the age of the thousandth-of-a-second computer solution, instant communication, instant satisfaction.

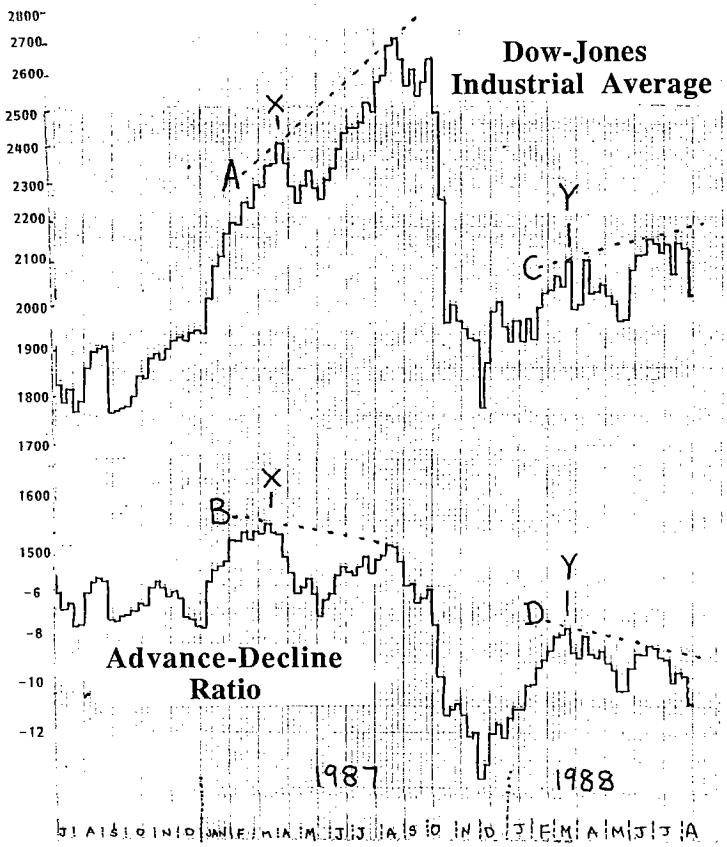
People expect everything to happen overnight. And believe me, the bear is going to take advantage of that impatience. How will he do it? By wearing out impatient investors, luring them into the market over and over again -- only to spit them out with losses.

So my advice is . . . take it easy, ignore bullish but uninformed forecasts by brokerage house analysts and financial columnists, concentrate on the big picture -- which is that this is a primary bear market, a bear market that could be as important on the downside as the 1974-87 bull market was on the upside.

Stay fairly liquid with the possible exception of T-notes, T-bonds, or the the highest-grade municipal bonds. Accumulate gold slowly and carefully. The marathon is on.

BREADTH: As veteran subscribers know, in my market analysis I always give greatest credence to "action of the market" studies as opposed to sentiment or monetary studies. How people feel about the market (sentiment) is open to opinion and interpretation. How the monetary picture will affect the market is also open to question and second guessing. But market action tells you what actually is happening on Wall Street. There are no ifs, ands, or buts with market action. If the Dow is up 3 points or if there are more declines than advances, those are cold facts about what the market actually did.

I give my studies of the Averages under Dow Theory first place in importance, and I give the breadth (A-D ratio) studies a close second place. For the benefit of new subscribers, the



advance-decline ratio is a very basic statistic. It is simply the differential in the number of daily advances and declines on the NYSE (I divide the daily differential by number of issues traded in order to adjust for the constantly increasing number of issues listed on the NYSE). This daily figure is then added (or subtracted) to the preceding day's figure so that the A-D ratio is actually a running total of the differentials. The A-D ratio shows us the direction of the majority of stocks on the NYSE.

The stock market likes harmony, and this means that the stock market likes the Averages to move in harmony with the majority of stocks as measured by the A-D ratio. When the A-D ratio diverges from a major stock average (I use the Dow), we have a state of disharmony. The market doesn't like disharmony. History shows that when the Dow and the A-D ratio diverge persistently, the market almost always corrects this disharmony. The market does that by erasing much or all (sometimes more) of the divergent move which produced the disharmony (this is true for movements on both the upside and the downside).

To illustrate this thesis I am including my longer-term chart of the Dow and the A-D ratio. This chart shows the Friday closes for the Dow together with the comparable Friday figures for the daily A-D ratio (in other words, of the five A-D figures tabulated each week, only the Friday figure is shown here).

1987: On March 25, 1987 (X on the chart) the A-D ratio hit a bull market high accompanied by a Dow bull market high of 2405.54. A sharp decline then took both indicators to May lows. A new rally advanced the Dow to its all-time high of 2722.42 (August 25), and this rise is represented by trendline A on the chart. In the face of the record Dow high, the A-D ratio failed by a wide margin to confirm. This divergent A-D action is represented by down-sloping trendline B.

What this meant was that after March 25, 1987, the majority of stocks on the NYSE refused to follow the Dow to new highs. This failure (and I wrote about it repeatedly at the time) was one of the major indications of the imminent topping-out of the bull market. In September we witnessed one final feeble rally attempt by the Dow to better its August bull market high. This rally failed, and it was

followed by the October 15 Dow Theory bear signal -- and then the historic October 19 crash.

1988: This year, incredibly, we see another March peak in both the Dow and the A-D ratio (Y on the chart), then a further recovery in the Dow (trendline C) accompanied by another declining A-D ratio (down-sloping trendline D).

On the week ending August 12 the market broke badly. By August 15 the A-D ratio had wiped out all of its gains going back to December 1987.

Conclusion: March 25, 1987 marks the day when the majority of NYSE stocks ended their bull market rise. Since then the trend has been DOWN for the majority of Big Board stocks. Bear markets are relentless, and the A-D ratio is telling us what the majority of stocks on the NYSE have been doing. In due time the A-D ratio will break below its 1987 bear market low. By the same token, the Dow (when it's ready) will get in harmony with the A-D ratio. This implies that the Dow will break below its October 19 bear market low of 1738.74.

CALM DOWN: Nothing created by the mind of man has ever equaled the stock market in terms of its sheer ability to frustrate people. Why is this? The answer is that the stock market frustrates because millions of traders and investors across the face of the US and the world are all trying to take money out of the market.

Now when 50 million people are trying to take money out of the NYSE or the AMEX or NASDAQ, you know right off the bat that it can't be done. A majority of people are not fated to make money doing anything, much less beat the stock market. "It's not fair" you complain, "why can't all those nice, well-meaning people make money with their trading and investing?"

There's one simple fact that makes this difficult. And that face is that throughout history going back to the days of primitive barter, there have always been a small number of financial winners and there has always been a mighty army of financial losers. So when we state that the stock market is "frustrating," we must qualify the statement by asking, "frustrating to whom?" And the answer again is that the stock market is frustrating to the great majority of participant-losers but highly rewarding to a small minority of informed, hard-working, intelligent winners.

Next question: What do you have to do to be one of the minority of investment winners? Answer: You have to work and work hard. It's an ironic fact that people are willing to work hard and put in long hours in their own businesses or on their jobs -- but then they think that they can turn around and make easy money in the stock market or in the bond market or even in the commodity markets. Beating the markets is the hardest endeavor in the world, and these supreme optimists believe that with a modicum of knowledge, little study, and a large portion of luck they can make money "playing the market." It doesn't work that way, never has and never will.

Here's an interesting illustration of what I'm talking about. The great, historic Dow Theory writing was done by Charles H. Dow, William P. Hamilton, Robert Rhea and E. George Schaefer. How many analysts, how many professionals, have read the works of these four men? How many pros have ever studied Dow's Theory, which, by the way, is the basis of all technical market studies? Frankly, I think I could count on the fingers of both hands the analysts I know who have read and are familiar with the works of these men.

As far as my own personal efforts, writing about the stock market or even investing in the stock market without studying the works of these pioneers would be impossible. I learned to think in terms of bull and bear markets from Dow's writings. I learned the history of the stock market from Hamilton's works. I learned how to read the Averages from Robert Rhea. I learned the real meaning of the primary trend from George Schaefer.

I added studies of my own to what I learned from the great analysts of the past, and out of all this I developed a stock market strategy and philosophy that seems to work. At least if seems to work for me and the majority of my subscribers. I try to give investors an approach to the market that I believe will help them rather than just tell them "what to do." To me, a typical list of stocks "that should double in the next six months" is useless. First of all, it's a touting approach to the market which I don't like, and secondly the odds are that few if any of the stocks on the list are actually going to live up to their billing.

The great Dow Theorist, Robert Rhea, wrote that if he was completely successful with his reports he would have no subscribers since in time they would all learn how to use Dow's Theory and would consequently have no use for him. I guess I feel the same way. Actually, my view is that 90% of my subscribers don't have the time or the inclination to be as obsessed with the market (as I am), and therefore they are paying me to do some of the work for them. They are also paying me to present history, to present my ideas, to present my investment philosophy, and to provide my bi-weekly views of the market.

That's legitimate, but I'll let you in on a secret -- I never want to be known as an expert or a guru. As far as I'm concerned, there are very few experts on Wall Street and market gurus (if indeed there have ever been any) are as rare as Australia's DoDo birds.

"All right," I'm asked, "then Russell, what the devil do you call yourself?" My answer is that I call myself "a market student," but an avid one. That title is good enough for me. And it is the way I view myself.

Why am I writing all this? I guess I'm writing it out of frustration. Every day I read dissertations and tomes on why the market is doing this or that, why if Bush gets in we'll have a good market, why if interest rates hold steady the Dow will hit 3,000, why if the trade balance will only improve we'll have a "New Era-type boom." And I say to myself,"How can this yo-yo get away with writing such nonsense? How can he mislead people so badly? How can I get over to subscribers the real picture, as I see it -- the real picture minus the bunk, the wishes, the uninformed theories, even the misconceptions about Dow's Theory?"

Then a little voice inside me says, "Calm down, Richard. You wouldn't have a business if everybody did the work, if all the analysts were brilliant and honest, if all investment knowledge could be put on VCR tapes."

So I guess I will calm down and just do my own work and let it go at that. Wall Street owes me nothing, my subscribers owe me nothing, and we all have a fair and fighting chance in this business. I love Wall Street although the truth is that I've never spent so much as a single work-day on the Street. But then, I've never been a chef, but I know a good meal when I'm presented with it.

NOTES & QUOTES: The major networks (ABC, NBC, CBS) are running into major trouble. By 1992 it is estimated that their share of national TV ad spending will drop to 45% from 1977's 60%. Meanwhile, cable TV's share will rise. What's happening? Cable TV and take-home VCRs are squeezing the big networks while PBS is offering top-rated, intelligent programs as is A&E. The public is slowly tuning the networks out. This year only NBC will show a profit.

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Republican Congressman Harris Fawell from Illinois has listed the things Michael Dukakis promises to do for the US if he is elected. They include (all from speeches): more money for students, farmers, teachers, blue-collar workers, workers on minimum wages, infants, the elderly, parents, families, the homeless, welfare recipients, universities, laboratories, urban America, rural America, small towns, big towns, factories, neighborhoods, communities, the war on drugs, the war on AIDS, the war on hunger, and the war on pollution, plus keeping a strong military. Fawell estimates that all this will lead to an increase of $185 billion over the next five years (in the most conservative estimate). Russell opinion -- we're going to have interesting times ahead.

Meanwhile, neither candidate is addressing the deficit problem in any intelligent way. Bush talks about a "flexible freeze," which is another way of saying we can grow out of the deficit (violin music, please). And Dukakis' answer is evidently to enlarge the IRS (ugh!).

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New York Times front-page headline from last week: "Republicans Press to Build UP Bush As Heir to Reagan." Russell comment: If that's what they're doing, they're making a mistake. I think people are disillusioned with the "Reagan revolution." They want change. If Bush doesn't offer change and a concrete platform, he's on his way to losing.

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Lee Iacocca on the subject of the two candidates (from Aug. 29 *Fortune*): "I've met and talked to both candidates. They're good, bright guys, but for the life of me I don't where they stand on the issues. . . . If they don't bring up the issues, then who will? We have to smoke these guys out, for the good of the country." Russell comment: Amen.

* *

China, what next? -- Sinochem has agreed to buy half of Coastal Corp. of Houston with a refinery in the San Francisco area. This will move China into California's huge gasoline and convenience store market. Sinochem is the refining and marketing arm of the oil industry owned by the People's Republic of China.

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The Vietnam War cost the US $130 billion. The Iraq/Iran War cost those two nations $400 billion. Nobody knows how much the Afghanistan War has cost Russia, but it must have been well over $100 billion. Nothing was gained out of any of these wars -- nothing. In the Russell opinion, nations from Africa to South America are realizing that war in today's world is a ticket to bankruptcy rather than increased power.

With this realization, the new arena for power is emerging, and that area is economics. In the new arena, the two so-called super-powers are already in trouble. Russia is saddled with a dinosaur economic system that doesn't work, while the US is saddled with $2.5 trillion of federal debt and a total of $8 trillion in total debt of all types.

Meanwhile, both super-powers nervously watch Asia where Japan, Hong Kong, S. Korea, Taiwan, Singapore, and now Thailand are world-class producers. China with 30 cent a day laborers is in the wings and moving fast.

* *

Currently, the hottest game in town is lending money to Russia (whose foreign exchange earnings have caved in along with oil prices). The Ruskies recently hit the Western capital markets with a $274 million Eurobond issue while Deutsche Bank is working out a $1.17 billion import-finance credit with the Russians.

* *

China: Between 1984 and '87, 3 million townships were set up each year. Rural enterprise output grew 40% annually and exceeded agricultural output value for the first time in '87. Chinese wages are small by Western standards and so are some costs. Often, factory workers pay something like 3% of total salary for rent, 5% for kindergarten care, 50% for food. Men retire at age 60, women at 55. Pensions at a good factory are 80 or 90% of the final wage. The Chinese have free health care until they die. (From the *Fraser Opinion Letter*, Box 494, Burlington VT 05402.)

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Statistic of the Week: The Pentagon now has 22,000 auditors, reviewers, and investigators. Yet the Defense Dept. is still rife with corruption. How can that be? "It's just another example of your tax dollar in action."

* *

Rip-Off of the Month Dept: "Congress already has begun to raid the Social Security trove. From the time that (Social Security) surpluses emerged in 1984, the extra receipts have routinely funded other Federal spending. Congress technically walled off the Social Security program by moving it to an 'off budget' status in 1985. Nevertheless, under current budget accounting rules, Social Security 'off budget' surplus is combined with the 'on-budget' deficit in other Federal accounts to calculate the total Federal budget." (From an Aug. 2 Salomon Bros. Inc. report.)

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Last year the Post Office's 800,000 workers (the nation's largest civilian work force) delivered 154 billion items (the number is climbing about 5% a year despite Fax). The PO is becoming a big bill collection and financial services agent for the US public. Incredibly, only 8% of today's mail is not related to business, while 40% of today's mail is so-called junk mail. In other words, as far as "people talking to each other," they don't use the mail anymore, they use the phone.

* *

OK, I'll bite -- why did George Bush pick a little known, 41-year old junior Senator from Indiana (a state that always votes Republican anyway) when he could have picked a name candidate with built- in vote-getting power? Best theory comes from columnist Safire of the *New York Times*. Bush is insecure about his leadership ability and wanted a younger man who would give Bush unquestioned respect and control. A Kemp or a Dole might have come on too strong, might have easily overshadowed Bush (Safire's theory sounds reasonable to me).

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Bush or Dukakis, they might each study this series of "famous last words." As a matter of fact, Congress might look it over too, since it is Congress that passes on the budget or presents a budget of its own. As far as the line-item veto power that President Reagan keeps begging for, that isn't going to be the final answer. Nor is supply-side economics -- we're not going to grow out of these deficits the painless supply-side way. The final answer will be a President and Congress who will have the guts to actually make the big cuts and take the political pain. So far, there are no candidates.

"Our goal, which is a goal we think we can achieve during fiscal year 1972, is to operate with a balanced budget." —*President Richard Nixon, July 1970*
1972 federal budget deficit: $23.4 billion

"We feel that you can hold the line and restrain federal spending, give a tax reduction and still have a balanced budget by 1978." —*President Gerald Ford, September 1976*
1978 deficit: $59 billion

"I intend to keep my commitment of a balanced budget at the end of four years." —*President Jimmy Carter, December 1976*
1980 deficit: $73.8 billion

"I have submitted an economic plan that I have worked out in concert with a number of fine economists, all of whom believe that it can provide for a balanced budget by 1983, if not earlier." —*Presidential candidate Ronald Reagan, October 1980*
1983 deficit: $207.8 billion

"This Administration is committed to a balanced budget, and we will fight to the last blow to achieve it by 1984." —*President Ronald Reagan, September 1981*
1984 deficit: $185.3 billion

National debt, 1972: $438.2 billion
National debt, mid-1987: $2.3 trillion

Actually, my own guess is that it will take a major crisis to halt the deficits. That or threats from our creditors, threats to the effect that they will stop buying our debt unless we get our house in order.

Many analysts and students of the picture firmly believe that the end result of these deficits will be "the usual" -- and they are talking about a massive rise in the US money supply in which the debts are literally inflated away. Personally, I doubt whether this can

happen. I doubt it because (as I've said so many times before) the US is now being run by the credit markets. The bond market, the mortgage market, the money markets, they run the nation. Start inflating and the credit markets will cave in as interest rates skyrocket. That's the threat hanging over the land. The moment of truth on the debts and deficits lies somewhere ahead, somewhere well past the election.

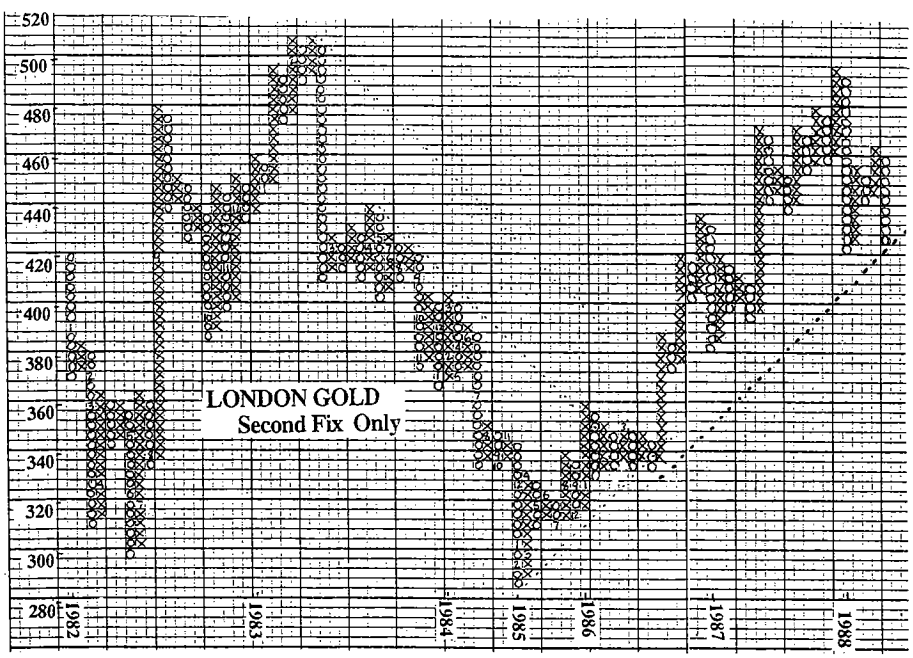
GOLD: Below is my point & figure chart of gold (2nd London fix only). This is a 4x12 chart meaning that each box equals 4 points and only rallies or declines of 12 points or more are shown. This concentrated chart tracks gold from 1982 to the present.

The main bullish trendline for gold comes in at around 428, but I'll give it a little leeway. Since the last low for gold was 424, I'll say that a spot price of 420 would break below the last low and also break below the bullish trendline. In other words, a London fix of 420 would be a bearish technical indication for gold, no question about it. Furthermore, gold has a rather toppy appearance on the chart, little question about that either.

But here are my comments. If gold breaks down, say below 400, I believe that such a move would have deflationary implications. Yeah, I know we're seeing all kinds of inflationary statistics at present, but the present is history as far as the markets are concerned. A gold break below 420 and certainly below 400 would be the market's way of saying deflation is in the future. And with the mountains of debt outstanding in the US today, a deflationary scenario would be ominous, to say the least (debt and debt payments loom increasingly large and painful if or when deflation enters the picture).

Now the second thing I have to say is that personally, from a totally selfish standpoint, I wouldn't mind if gold broke to 350 or even 300. The reason is that I want to accumulate gold, and the more gold I can get for my dollars, (naturally) the better I like it. Somewhere in the future, and it could be a year or five years away, I believe gold is going to take off on the upside, and I want to be there -- with plenty of gold in my possession.

As far as I'm concerned, gold isn't an investment because it doesn't provide a return, and it isn't a speculation -- because I'm not buying it to sell it at a profit next week or even next year. I buy gold because the history of gold is that it holds its purchasing power (despite interest lost since there's no return on gold). I buy gold because it represents a medium of unquestioned intrinsic value in a world where almost everything you see, from cars to homes to dollars is someone else's debt.



I worry about a lot of things. I worry about the dollar, I worry about the stock market, I worry about the bond market, I worry about a Bush or a Dukakis administration, I worry about crime, my kids, AIDS, the world population explosion, the vanishing ozone layer, the decimated forests, rising taxes, filthy air, and that's just the beginning of the list. But I don't worry about gold. Yes, one of the things I like about gold is that I don't worry about it. Gold will be here, gold will possess real purchasing power when my kids are grandparents. At which time they'll have their own worries, but I sincerely doubt if gold will be one of them.

NEW: I've added an item to the page 1 statistics-- the percentage of undervalued blue-chip stocks, a figure compiled by *Investment Quality Trends* (7440 Girard Ave., La Jolla, CA 92037). This is a critical statistic. At bear market bottoms this percentage will rise to near 80% or more. At bull market tops this figure will shrink to near 15% or less. It is now 20%, more indicative of a bull market top than a bear market bottom.

LATE NOTES: Negative progress: Two days after the crash, on October 19, the Dow closed at 2027.85. Last Friday (August 19), 10 months after the crash, the Dow closed at 2016.00. The year 1988 has been "playtime for the bear." He'll get serious soon.

Values tend to diminish as a primary bear market wears on. It's been a year since the August '87 bull market top, and the Dow is 706 points below its '87 peak as this is written. That amounts to a decline of roughly 59 points a month. I would say that is probably about the rate of loss we can expect throughout the length of this bear market (of course, the declines will be erratic but I'm talking about the average monthly loss between here and the ultimate bear market bottom).

The breaking of the May lows (on Aug. 10) by the A-D ratio gives a nasty look to this market, and already some of the more vociferous bulls are toning down their bullish enthusiasm. Daily new lows are now outnumbering new highs on the NYSE and my feeling is that this "recovery rally" is on borrowed time (actually, the majority of NYSE stocks peaked out last March 17, when the A-D ratio recorded its 1988 high).

The August 22 *Barron's* headlines its article "The Coming Collapse of Home Prices." The piece is highly informative and I consider it "must-reading." The real assets and savings of the American public is not in stocks, it is in their homes. If the price of homes starts sinking (and this is already happening in certain areas), we'll begin to see what this bear market is all about.

Meanwhile, the authoritative *Bank Credit Analyst* notes that "The US current account deficit has failed to improve sufficiently, still requiring $155 billion of foreign money each year to finance the shortfall." They add, "US net indebtedness to foreigners is currently $610 billion or 13% of GNP and rising dramatically, an unprecedented situation for a reserve currency."

Note the action of the PTI on the page 2 chart. The PTI has been plunging recently, and this indicator is now only a dozen points above its 89-day moving average and dropping rapidly. If this week (week ending Aug. 27) is sloppy, the PTI will probably go into a bearish mode.

Both S&P and Jim Grant have published charts of the Japanese Nikkei average and the Japanese A-D ratio. The A-D has been sinking violently ever since April of this year. I don't know whether things work the same in Tokyo as they do here, but it's an ominous profile!

Parting Russell thoughts: (1) I'm glad I'm not Alan Greenspan. (2) Try as I might, I can't see Dan Quayle as President of the United States.

NEXT MAILING: Sept. 7